8/23/83 R5650-2 A

JAPAN · ECONOMIC · INSTITUTE

JEI REPORT

No. 31A August 19, 1983

THE IMPACT OF CHANGING CONSUMPTION PATTERNS ON JAPAN'S ECONOMY

Summary

Japanese government officials believe that stable economic growth sustained by domestic demand is essential if they are to improve economic relations with their trading partners and avoid large trade surpluses. To this end, personal consumption, which accounts for more than 50 percent of the gross national product, is expected to lead economic growth. However, bracket creep in the absence of income-tax cuts, increases in social security contributions, and lower wage increases have resulted in some stagnation in personal consumption. Current statistics indicate a structural change in Japanese consumption patterns with an increase in the share of total household spending on expenditures for services. This report will analyze the shift in consumption patterns and its effects on Japan's economy.

Introduction

Personal consumption in Japan, which had shown a real (inflation-adjusted) growth rate of only 0.7 percent in fiscal 1980 and 1.1 percent in 1981, began to recover in 1982 and recorded a 4.7-percent increase. Taking into account this figure as well as various trends in personal consumption, government economists forecast that 1983 would show a 3.9-percent increase — a rate which would be a strong influence toward economic recovery.

However, the monthly survey for nominal household spending in May showed a 0.9-percent drop over the same month of the previous year, following a 0.2-percent dip in March and a slight 1.8-percent rise in April. These figures give rise to some concern as to whether the expected increase will be attained. Explanations for the lower level of consumer spending hold that disposable income is down due to higher taxes and larger social security contributions. These expenditures for fiscal 1982 rose 14.0 percent.

Disposable income increased only 5.1 percent, but the average propensity to consume also increased — rising to 79.5 percent — so that spending rose 5.2 percent. Adjusted for inflation, the real gain was only 2.7 percent.

Government officials say the May decline was a result of cool weather (which affects summer purchases), low wage increases in the spring labor contracts, and anticipation of a reduction in the summer bonus. Consumers generally respond to a slowing of disposable income by reducing outlays for manufactured goods, including clothing and consumer durables. A sharp decline in expenditures for automobiles (down 65.0 percent from a year ago) also affected total household spending figures for the month. However, expenditures for medical and recreational expenses, both in the services category, were up 7.7 percent and 7.5 percent, respectively. Expenditures for services, though they are optional, tend to be fixed and are not cut even in a recessionary period. A hike in consumer spending for services is also evident in the long term. Indexing the level of personal consumption in 1970 at 100, consumer spending rose to 125 in 1982. However, expenditures for goods increased only to 113, while spending for services grew to a hardier 132.

Consumer Spending in Japan

The proportion of income spent on food in Japan rose from 0.60 after the war to 57.4 percent in 1950. During the same period, expenditures for clothing were about 10 percent. By 1955, expenditures for both these categories had declined to 55.5 percent, as high economic growth spurred widespread purchases of high-ticket consumer goods, including automobiles, television sets, refrigerators and washing machines. As a result, leisure time increased, and with the expansion of the economy, demand for services advanced. After the 1973-74 oil crisis, an increase in consumer prices led to a contraction in the proportion of spending for merchandise, but did not halt rising spending on such costly services as education and health care, which are not entirely discretionary.

Annual surveys show the changes in spending patterns. The consumer survey for fiscal 1982, for instance, cites a 5.2-percent upturn in Japanese household expenditures (2.7 percent in real terms) over the previous year. A breakdown shows furniture and household utensils up 4.0 percent, recreation up 3.9 percent and medical care up 1.4 percent. Real declines were reported in clothing (down 1.5 percent) and education (down 7.2 percent). Purchases of foodstuffs declined slightly (e.g., cereals were down 1.0 percent, fish and shellfish down 1.5 percent) but supplementary food industry items, including pre-cooked food and restaurant meals increased by about 3.9 percent.

As shown in Table 1, the ratio of food costs to total household expenditures has fallen in the last 12 years, from 34.0 percent in 1970 to 29.0 percent in 1980 and 26.7 percent in 1982. Clothing slipped from 9.5 percent in 1970 to 7.1 percent in 1982. The proportion of income spent on furniture and household appliances also declined. In contrast, the percentage spent on education, transportation and communication increased during the same period. In 1970, expenditures for goods versus services were 73 percent and 27 percent respectively, shifting in 1980 to 67 percent and 33 percent. By 1982, services, including utilities, education, medical care, transportation and communication accounted for one-third of total household expenditures. This trend is also evident in the data for total domestic production. The government's 1980 input-output table shows that the share of service industries to total domestic production increased from 11.6 percent in 1975 to 12.7 percent in 1980.

The JEI REPORT (ISSN 0744-6489) is published weekly for $40 per year by the Japan Economic Institute of America, 1000 Connecticut Avenue, N.W., Washington, D.C. 20036. Second class postage paid at Washington, D.C. POSTMASTERS: Send address changes to JEI, 1000 Connecticut Avenue, N.W., Washington, D.C. 20036.

Factors Involved in Consumption

This change in household spending patterns has several causes. First, consumers have satisfied most of their needs. Figures show the proportion of total households owning durable goods in 1980 was 99.5 percent for refrigerators, 96.9 percent for vacuum cleaners, 98.9 percent for color television sets, 62.0 percent for passenger cars and 42.2 percent for air conditioners.

Second, leisure time has increased as working hours have been cut, and weekends are often devoted to recreation. In 1970, 31 percent of the workforce was employed more than 48 hours, but in 1975 only 17 percent worked more than 48 hours. Saturdays were workdays for 79 percent of all employees in 1970, but by 1975, the turnaround gave the same 70 percent Saturdays off.

Third, participation of women in the labor market has increased, due to a decline in the number of children, the use of electrical appliances and changes in the industrial structure. The number of women at work was recorded at 21.4 million in 1980, — 38.7 percent of the workforce. Moreover, the rapid development of the media and the emphasis on higher education have contributed to a robust demand for information and leisure. That, in turn, has led consumers to an interest in higher quality, more convenience and more comfort. Simultaneously, the business sector has increased its needs for information and telecommunications services, elevating the status of the departments in charge of these facilities and emphasizing higher standards of efficiency and expertise. As a result, demand for lawyers, business consultants, maintenance and security personnel have increased.

For their part, basic industries — which have been adversely affected by increases in energy costs and the global downturn — have been overtaken by a shift to a more service-oriented industrial configuration. As table 2 shows, ratios of pretax profit to net worth have been larger in the service industries than in the manufacturing sector since the oil crisis. Profitability in the service area has accelerated this transfer.

Service-Oriented Consumption

Services have a different character than goods. For one thing, production and consumption of services take place simultaneously. Moreover, the production of services is highly dependent upon the skill and ability of the supplier, and there are fewer economics of scale than in the production of goods. Therefore, prices of services are likely to rise over time relative to manufactured goods, but lack of acceptable substitutes may reduce their price elasticity (the negative effect of price increases on demand). For example, even if parents know about a tuition increase in college for the next year, they are unlikely to revise their children's educational goals. The service sector also requires far less capital. As the economy progresses to this stage of maturity, individual savings also tend to increase and the liquidity of the business sector tends to rise. Thus, a decline in the demand for investment funds by business and an increase in the supply of savings creates a surplus of funds in the market which will seek profitable investments.

Another legacy of the economy's new direction is the change in the importance of consumption. Historically, total sales at department stores and supermarkets have been used as indicators of personal consumption. But in 1982, retail sales were flat while personal spending picked up because consumers did less of their spending in department stores and supermarkets. With an increase in the ratio of services spending to total consumption, there is less spillover on manufacturing output than is the case when consumers purchase goods. Yet another product of the growth of the service-oriented economy is its greater positive impact on employment (because of the relative lack of economies of scale), especially because the manufacturing sector is headed toward robotics and mechanization.

Ministry of Finance Study

A Ministry of Finance (MOF) study group analyzing structural changes in the economy has proposed a new system to cope with the change of prime weight from hardware to software called "soft-nomics." The study calls for a new approach to economic management compared to that under the high economic growth period to reflect the expansion of the service industry and the shift to service-oriented consumption.

More specifically, the report recommends reconsideration of Keynesian economic policy, promotion of fiscal reform, an emphasis on the private sector, and a review of the data on which the gross national product is based. The report notes that tertiary industry (which includes much of the service industry) in 1980 accounted for 59 percent of the gross national product and in 1982 employed 55 percent of the workforce. The weight of software in the secondary industry (which is primarily manufacturing) also has increased, in expenditures for design, advertising, marketing, planning, information and research, the report indicated. Since the structure of the economy is now orientated to qualitative improvement, the report said, a return to Keynesian theory, a reliance on the private sector, and a curb on government intervention were essential. The report then called for strict control over fiscal spending to curb inflation and cut the huge fiscal deficits.

Capital spending requirements, the group reports, will be smaller in the "soft" sector than in industries such as heavy machinery and chemicals. Therefore, while loan demand will decline, liquid corporate assets will increase, creating a strong awareness of, and preference for, higher interest rates. The report noted that the software economy will contribute to the importance of monetary policy over fiscal policy, and called for a refinement of statistics on the service industries and more detailed industrial classifications.

A contradictory view was outlined in the Economic Planning Agency (EPA) survey on Japanese consumer spending. According to EPA analysts, consumers are still buying durable goods and there is no discernible trend to service-oriented consumption. EPA officials reported that a nationwide sampling of about 8000 households shows that more than 10 percent purchased three types of goods — color television sets, carpets and cars — as additions to or replacements of earlier purchases, suggesting that Japanese consumers still have an interest in purchasing durable consumer goods.

In general agreement with this position, a Mitsubishi Bank Ltd. report says that the increase in expenditures for services was actually the result of substantial increases in the price of services. It notes that the ratio of service expenditures to total spending of households (after inflation) accounted for 41.9 percent for the first half of 1982, up 4.4 percentage points over 1973, (prior to the oil crisis). According to the report, the prices of goods were 1.9 higher, but services were up 2.4 times. In particular, essential services increased substantially, such as postal charges (up 3.5 times), tuition (up 3.4 times), train fare (up 2.8 times), and gasoline (up 2.7 times).

Effects on Economic Indicators

Reliance on data used in previous formulations is not useful in evaluating the new trend. Purchases of clothing, food, furniture and major appliances account for less than 40 percent of household expenditures, but more than 80 percent of total retail sales, thus diminishing the usefulness of retail sales volume as an indicator of consumer spending. The index of industrial production, also used as an indicator of economic activity, only accounts for about 30 percent of the gross national product.

As a result, the Ministry of Finance (MOF) has changed its methodology. Instead of evaluating the economic situation on the basis of reports from each branch office, MOF now analyzes corporate quarterly reports and has issued a new industrial classification that divides "tertiary industry" into 13 categories, including financial institutions, wholesalers, retailers, information vendors, lease and computer services, culture and sports industries. It has also included small- and medium-scale businesses in its samples.

The Economic Planning Agency is also reviewing a new index of economic activity which will introduce household spending as a "lagging indicator." At the same time, EPA will modify its quarterly economic survey of corporate activity, increasing the number of corporations surveyed from 2,000 to 4,000 and adding a number of new survey items such as employment and financial status. And the Bank of Japan, which releases short-term economic surveys every quarter, has also added 2,000 businesses to the number of enterprises surveyed, with the increase mainly in non-manufacturing activities.

Conclusion

With a 60-percent share of total industry in terms of production and employment (about 10 percentage points less than in the United States), the service sector in Japan is soon expected to reach the same level of importance as in the United States. This process brings some concerns. For one, the productivity growth of the economy will decline and it is possible that the underground economy will expand, although the decline is offset by the fact that services require more manpower. Because they are able to absorb excess supplies of labor at a time when manufacturing industries are paring their work forces and introducing technology to eliminate labor, their importance should not be underestimated. The nature of the service sector means that some expansion of the underground economy may not be avoidable, but that problem could be handled by improved tax collection methods. In any case, the expansion of the service industry should not be hindered by concerns over declining productivity growth or taxation problems.

It can be expected that the economy will stabilize at a slower growth rate as it depends more on services, but as mentioned earlier, the current statistics do not offer much guidance. The revision of economic indicators will be helpful in an evaluation of the effects of changes in the economy.

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Table 1: Composition of Household Consumption Expenditures

	1970	1975	1980	1982
Food	34.0%	32.0%	29.0%	26.7%
Housing	4.9	4.9	4.6	4.7
Utilities	4.4	4.5	5.7	5.7
Furniture & Household Appliances	5.0	5.0	4.3	4.2
Clothing	9.5	9.2	7.9	7.1
Medical Services	2.7	2.5	2.5	2.3
Transportation & Communication	5.2	6.1	8.0	9.0
Education	2.7	2.8	3.6	3.8
Recreation	9.0	8.4	8.5	8.6
Other Living Expenditures	22.6	24.8	25.8	27.9
Total	100.0	100.0	100.0	100.0

Source: Prime Minister's Office

Table 2: Ratio of Profit to Net Worth

	1970	1973	1975	1976	1977	1978	1989	1980	1981
All Industries	29.4%	37.7%	13.5%	20.6%	20.3%	23.9%	28.4%	27.4%	21.1%
Manufacturing	29.2	38.3	8.3	18.9	19.5	22.6	30.1	26.4	20.8
Services	33.9	30.6	16.1	27.4	29.2	39.6	38.8	32.0	28.0

Note: The profit figure used here is what the Japanese call "current profit," which is pretax profit exclusive of profit or loss from non-recurring activities.

Source: Ministry of Finance